Dec. 29, 1999 LETTER 1294

RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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THE PICTURE: On July 29, my Primary Trend Index turned bearish at a value of 5353, as it broke below its 89-day moving average. On August 4, the Transports gave one-half of a Dow Theory bear signal when they broke below their preceding low of 3316.11. On September 23, the Industrials confirmed Transport weakness by breaking below their own preceding low of 10466.93. Under Dow Theory, the confirmatory break by the Industrials on September 23 signaled that the primary trend of the market had turned down and that a bear market was in force.

Market action since then has been the most unusual that I have ever seen. The advance-decline ratio had topped out earlier on April 3, 1998. Following April 3 the majority of stocks on the NYSE headed lower, with the A-D ratio hitting successive low after low -- right up to the present.

But beginning in August 1999 we witnessed a most extraordinary situation. Even as the advance-decline ratio and my PTI continued their decline, the Internet stocks and many tech stocks surged to successive new highs. So frenzied was the buying in Internet and new start-up net stocks, that many analysts labeled the situation a mania. From a low of 241 on August 10, the Internet Average (IIX) rose to a high of 544 on December 13 -- all this in a period of only four months.

The tech/net "mania" has served to cover up the dismal performance of the majority of stocks on the NYSE as measured by the advance-decline ratio. For the period of April 1998 to December '99 the A-D ratio has lost over 18 points. Few people realize that this is comparable to the loss by the A-D ratio during the disastrous year 1974 (subscribers who own my advance-decline albums can verify this).

Example: On the week ending December 17, of 3,685 stocks traded on the NYSE, 1,116 of those stocks hit new 52-week lows. In other words, 30.2% of all stocks traded or almost one-third of all the stocks traded on the NYSE that week hit new lows.

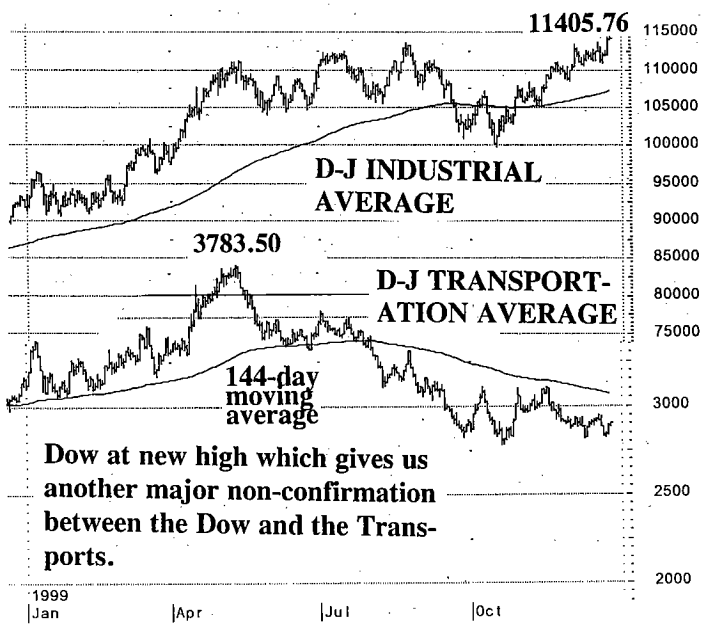
And I ask myself, what is the **meaning** of this strange, lop-sided action? **What does it mean when the majority of stocks on the NYSE (and the Nasdaq) continue to sink week after week? What does it mean when 30% of all the stocks traded on the NYSE hit new lows?** Can the two groups, the tech/net groups, drag the majority of stocks up and out of their bear market? Or will the power of the primary bear trend sweep over the entire market, once the net-tech mania wears itself out?

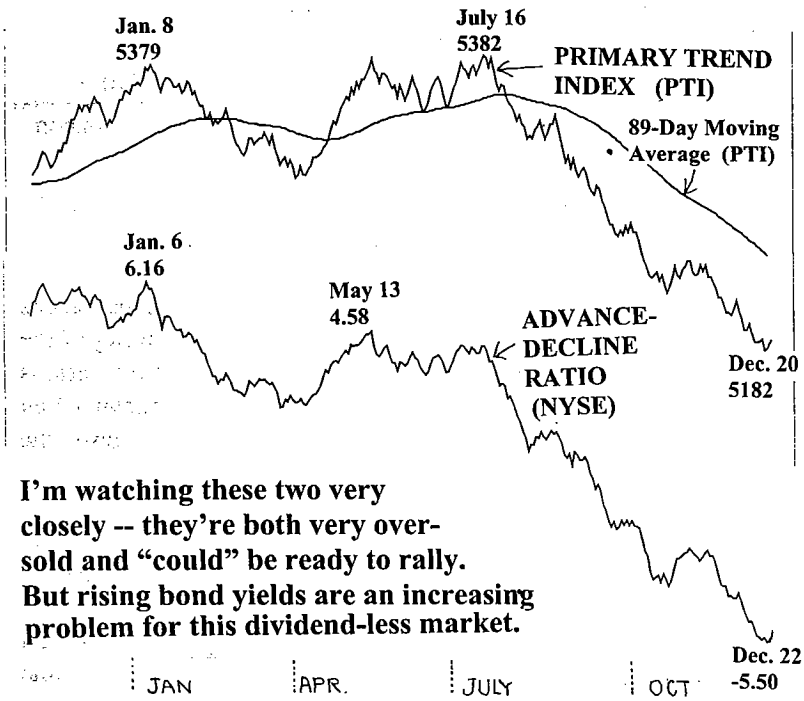
Analysts appear fixated on the action of the Internet stocks and tech stocks while little is said about the **meaning** of the steady decline in the great majority of stocks on the various exchanges. And I ask myself, **"What does it mean when three-quarters of the stocks on the NYSE (and the Nasdaq) continue to head south?"**

Here's my "pre-millennium" guess. I think this huge and continuing decline in breadth is telling us that we're heading into either an economic slowdown next year, a profit squeeze or an actual recession. I've just never seen a decline of this duration and extent in the advance-decline ratio which didn't bespeak of trouble ahead.

Comment: For most of stock market history, the concept of dividends and yields played a major part in stock market analysis. But during the mid-90s something new occurred. The Dow and the major averages continued higher, even though the Dow yield dropped far below the time-honored danger level of 3%. In the new market of the '90s, growth and momentum became the password and yield was totally ignored. Over the last few years, the yield on the Dow dropped below 3%, then below 2%. Investors didn't care. They continued to buy stocks, advancing the Dow to successive new highs.

Having ignored low or non-existent dividend yields for years, investors and speculators have now decided to ignore





I'm watching these two very closely -- they're both very over-sold and "could" be ready to rally. But rising bond yields are an increasing problem for this dividend-less market.

price action in the majority of stocks as well. For 20 months, we've watched the advance-decline ratio decline. Investors seemingly couldn't care less. The majority of stocks, we are told, are simply part of the "rusty old economy" of the past -- the tech and net stocks are "where it's happening in the new economy."

As this is written, only 27% of the stocks on the NYSE are above their long-term or 200-day moving averages. As this is written, two-thirds of all the stocks on the NYSE are down for the year. This is a true bear market, but so far, this is also the most deceptive bear market in Wall Street history.

All securities are ultimately judged by the return on the investment. Stocks must either go up (capital gains) or pay attractive dividends or preferably both. Most Internet stocks generate no profits and pay no dividends. Therefore, they must be judged simply on their potential. Unfortunately, it's too early to gauge just how any given Internet stock will fare in the current highly competitive climate. Despite this, most net stocks have risen to heights that can't be justified by any "normal" methods. When two- and three-year old companies command market values in the billions of dollars, many analysts (mostly old-timers) label the situation a "mania."

I place myself in the mania camp. I believe what we are seeing is a mania in the true sense of the word. In stock market history, manias have not ended well. I don't think this one will end well either. I might add that the problem is not the concept of the new technology or the future of the Internet. No, the problem is the market's wildly-enthusiastic **pricing** of these new securities. But as I said, ultimately everything comes down to the return on the investment.

Who's Doing What? I'm indebted to Steve Briese of *Bullish Review* [(888)423-4950] for the following: The Commercials are the big houses such as Goldman or Merrill. The latest tabulations show that the Commercials have a short position in the S&Ps of 21,612 contracts, a huge short position. Since options are a zero-sum game, there must be that same amount of options on the other side. Taking the other side (against the Commercials) are the Large Speculators (commodity funds) and the Small Traders (the latter tend to be the least-informed and least well financed of the trader groups). Interestingly, the Small Traders now have a near-record long position of 25,972 contracts. Writes Briese, "We cannot recall a time when Small Traders as a group profited by going against both large trader categories -- and was able to bank those profits." **Russell Comment:** In other words, the Commercials now have a huge short position while the Small Traders have assumed a very large long position.

INVESTMENT POSITION: No change from the last Letter. Most stocks are declining, but techs and nets are still rising. Therefore, I'm putting a bear in the box representing the trend of the majority of stocks and a smaller bull in the box, the bull representing the nets and techs.

In my mind, the bargains in securities today are the muni bonds. Good muni bonds, tax-free federal and state, have been hit hard and are now yielding near 6%. If you're in a high tax bracket, these bonds are worth a yield of anywhere from 10% to 12%. I would stick with bonds which are rated at least AA.

Many closed-end muni bond funds are now yielding up to 7% or a bit more (giving you a tax-equivalent yield of up to 12% or more). Most of these closed-end funds are selling at discounts from net assets of anywhere from 10% to almost 20%. However, I generally don't recommend muni bond funds over the actual muni bonds. The reason: When you buy a bond fund you are not sure of getting your money back. If the fund manager trades poorly, the fund can be hit hard. However, when you buy an actual bond, you will get your money back at par (1000) when your bond matures -- unless your bond is called, and if it is called it's usually at a price above 1000 (continued on page 3).

What do we do next? My advice, my instinct -- first let's get by early January. In general, bonds and particularly muni bonds are becoming very attractive. But it boils down to this -- what would you rather have, fat guaranteed income now (bonds) or no income (buy techs and nets) with the **hope** that these stocks just keep rising and rising and rising?

ANNOUNCEMENT: I've been providing subscribers with six days a week Internet market comments for about nine months now (www.dowtheoryletters.com). And honestly, it's a lot of work. However, I've enjoyed doing it, and I do feel it adds a good deal of value to this service. Things move fast these days, far faster than they used to -- and I feel that my daily (plus weekend) Internet comments keep subscribers up-to-date on market conditions and on my latest thoughts.

However, this is a heavy schedule for an old-timer like me (it would be a heavy schedule for a young-timer). Therefore, I am going to change my schedule on the regular "paper" Letters. Instead of a Letter every two weeks, I'm going to change my schedule, ease up a bit, and send a Letter **every three weeks.**

I feel that this, together with the daily Internet comments, offers a much better value and far more timely coverage than what I offered a year ago with just the Letter and no daily Internet comments.

But question -- what if you don't have a computer or don't know how to get on the Net? At this point there's really no reason why anybody and everybody shouldn't be on the Internet -- not just to read Dow Theory Letters, but because the Internet is the new way of staying in touch with the world. Yes, I know that computers tend to be "user-unfriendly." But there are now a number of simple devices which allow you to get on the Internet **without a computer.** There are set-top boxes (web TV) which run through your TV set. There is the very simple new I Opener [call (888)I-opener] in which you simply plug this device into an electric outlet, plug the other wire into a phone line, and presto, you're on the Net. My recommendation, visit your nearest computer or electronic store and let them show you how easy it now is to get on the Net - **without a computer.**

Comment: I'm convinced that the trend is increasingly away from computers and to non-computer methods of access to both the Internet and to e-mail. Non-computer devices that get you on the net are becoming simpler and much more numerous.

The price for the "new" Dow Theory Letters plus daily comments remains the same -- $250 a year and $150 for six months. Thanks.

NOTES & QUOTES: With well over 4,000 subscribers now tuning into my web site daily, the e-mails are pouring in. On a typical day I receive anywhere from 20 to 30 e-mails -- and on Dec. 13 I received 42 e-mails. Many of these e-mails contain excellent information, interesting comments, a few reasonable complaints. I simply can't answer all these e-mails. But the first thing I do every morning is read them. And I appreciate the effort that goes into writing them.

* *

In political elections like everything else, money talks. For this reason I find the **Iowa Electronic Market** (on the net) most interesting. Here you place actual money bets on politics and politicians; if you win your bet you get one dollar. If you lose you get nothing. The betting runs like this; currently you put up 59.1 cents for a Giuliani win. In other words, if Mr. G. wins you get one dollar. If he loses you get zip. For Hillary you currently put up 32.4 cents to get a dollar back. So with IEM real MONEY is saying that the odds are 59 for Giuliani as against 32 for Hillary. For the Democratic National Convention, it's 31.3 for Bradley and 70.4 for Gore. For the Republican Convention, the prices are Bush 73.5, McCain 24.2, Forbes 2.7. The odds are updated electronically every 15 minutes. **Russell Comment:** I'm still not convinced that Hillary will run. If she runs, she won't win.

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I'm constantly looking for good web sites. They're frankly hard to find. The one I find most useful from a stock market standpoint is **www.decisionpoint.com**, which does a great job with a long list of charts and statistics. This site now charges $10 a month and it's well worth it. For general and specific information, I particularly like two sites -- **www.askjeeves.com** and **www.google.com.** These two sites are terrific.

* *

Is there a "cool war" on the horizon? You can see how worried the US is about Y2K. Well, consider this: a recent article in the Chinese Liberation Army Daily was very direct in its assessment that integrating Internet warfare with traditional ground, sea and air warfare would be essential in winning the next war. The article suggested that power grids, air traffic and even e-commerce would be part of the next battlefield. The White House is taking the idea of "web warfare" so seriously that it will soon unveil a series of near-term and long-term measures all aimed at protecting the national infrastructure.

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Wealth creation: On the two days of December 15 and 16,as Microsoft surged, Bill Gates' net wealth increased by $10 billion. That's a lot of money. In fact, 20 years ago nobody's entire assets were equal to $10 billion. But in the world of today, Gates gained that amount in two days. It's just a new world out there, and Gates has it by the throat.

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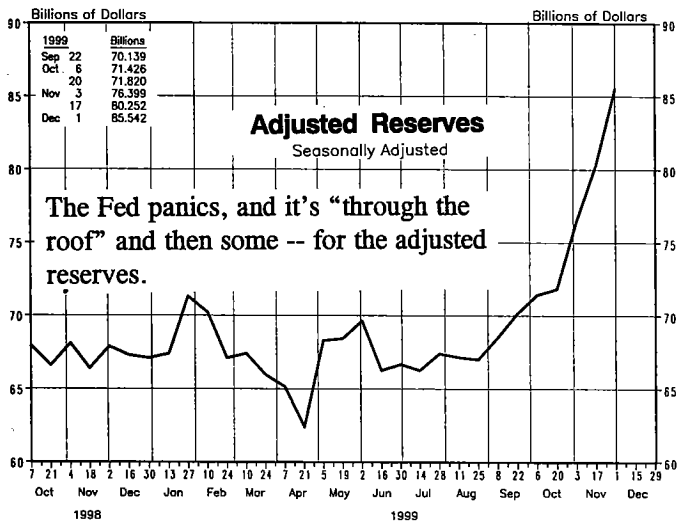
THE FED and Y2K: Obviously in fear of what Y2K might portend, the Fed under Greenspan has released the greatest expansion of the money supply in history. This latest chart from the St. Louis Fed shows adjusted reserves, which are now sky-rocketing -- since August 28 Adjusted Reserves have risen at the unprecedented compounded annual rate of 69%. Clearly, the Fed is insuring that in the face of possible Y2K trouble, the nation will be flooded with money.


Billions of Dollars
Billions of Dollars
1999 Billions
Sep 22 70.139
Oct 6 71.426
20 71.820
Nov 3 76.399
17 80.252
Dec 1 85.542
Adjusted Reserves
Seasonally Adjusted
The Fed panics, and it's "through the roof" and then some -- for the adjusted reserves.
Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
1998
1999

In view of the Fed action, I ask myself (1) The Fed has the best inside information. Why then are they flooding the market with reserves? (2) The second thing I ask myself is why can't the majority of stocks rise in the face of the greatest injection of liquidity in US history? (3) The third thing I ask is what happens next year when the Fed will almost surely cut way back on reserves?

Many analysts believe that this ocean of money has been responsible for the market's wild rise (and specifically the rise in the Internet and tech stocks) since last August. The question is what happens in January and beyond, and I'm not talking about Y2K (nobody knows how Y2K will impact on the economy). No, I'm talking about this massive money supply -- will the Fed try to sop it up, or will they raise rates a half-percent or will they just stand by and hope that all will be well?

The Fed's action, despite what you hear from your government, tends to debase the currency. As I've mentioned before, the Federal Reserve came into being in the year 1913. Since then, the dollar has lost 95% of its purchasing power. Along these lines, I happened to be reading about British King Henry I, who resorted to drastic measures when he found that his money changers had been issuing coins of inferior value. Henry ordered 94 of his 150 moneyers to be castrated and have their right hands cut off. I'm not suggesting that Mr. Greenspan and his cohorts be subject to the same penalties. But as a guy who remembers good dinners at a buck a throw, it does irk me to see what the people at the Fed have done to our currency.

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The daily publication, *Venture Wire*, lists on average about 20 deals which usually add up to anywhere from $100 to $200 million. The enthusiasm for new US start-ups has been phenomenal and will probably add up to roughly $50 billion for 1999. This is 10 times the amount registered in 1994. My wife, Faye, is a lawyer with a large law firm. Her firm is one of largest law firms in the US specializing in IPOs, mergers and acquisitions, mostly for tech firms. I can tell you that the urge to "pack it in" and go with a new start-up is almost overwhelming. Everybody wants to make a quick 100 million today. The nearest thing I can think of to what's happening today equates with the California gold rush of the mid-1800's when men (and women) would leave everything behind and head out to California and the promise of hopefully making a fortune by staking out a gold claim. Writes the *NY Times* of today's conditions, "The fact that virtually any idea -- no matter how dubious -- can obtain money, and that so much money is available, is also causing problems. Competition among Internet companies is increasingly a financial arms race. They must raise huge war chests, give away their products, advertise on TV, and pay insanely high salaries -- simply because their competitors do. The glut of money also has companies -- and the industry as a whole -- growing insanely fast, leading to labor shortages everywhere -- of not only engineers and managers, but graphic designers, accountants, headhunters, telephone system installers."

* *

The PC could be on the way to becoming obsolete. A net device is now sweeping Finland, and Finland is the most wired and computer-happy nation in the world (it's the home of giant Nokia). The new device is called wireless application protocol or WAP. This new system allows mobile phones to tab into the Internet. WapIT, the sales outfit for WAP, is now blanketing downtown Helsinki. Demand for the new phones is so hot that NOKIA, the world's largest cell phone maker, can't keep up with them. The WAP madness is about to hit the US. Some call it the "post-PC age." **Russell Comment:** I've been using PCs for years, and my considered opinion is that they are **still not user friendly.** They do weird things, they jump around, they scramble, they crash, they go dead. For most people PCs are a marvel but also a pain in the fanny. In the end, I think set-top boxes and probably WAPs will be the favored devices for the average person. The old expression, "Keep it simple" just does not apply to PCs -- unfortunately.

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The number one stock in Finland is now Nokia, the mobile phone maker. A few weeks ago Nokia became the biggest-capitalization stock in Europe. Nokia now makes up 69% of the value of the entire Finnish stock exchange.

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Does Wall Street love a bull market? You can bet they do. Talk is that bonuses this year will be 18% above last year or around $13 billion. The Wall Street prosperity has driven rents and property values in Manhattan "through the roof."

Record Wall St bonuses of $13bn expected

By John Labate in New York

A New York City official yesterday said he expected year-end bonuses on Wall Street to reach a record $13bn this year, 18 per cent higher than last year.

The estimate comes as leading investment banks and brokerages put the final touches to bonus plans, closing a strong year in merger and acquisition activity and initial public stock offerings.

Alan Hevesi, New York City comptroller, made the prediction at a conference

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There are now 491,000 foreign students studying in the US. China (no surprise) is the number one supplier, with 10.4% of the students, followed by Japan and Korea. If you want proof, just take a walk around UC Berkeley on any day including Sunday. The university with the largest number of foreign students is my alma mater, New York University, with over 4,000 foreign students now attending.

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I note that *USA Today* (Dec. 10-12) has voted Muhammad Ali the "Athlete of the Century." I don't really agree. If the Athlete of the Century is to be a boxer, I would pick Sugar Ray Robinson (and by his own admission, so would Ali). Robinson was, in my opinion, the greatest boxer, weight for weight, of all time. His form was poetry in motion, he

could out-box any opponent and if it came to a slug-fest (which it often did) he could out-slug such famous brawlers as Rocky Graziano, Jake La Motta and Tony Zale. In fact, Ali modeled his boxing on Sugar Ray. The remarkable thing about Ali was that as a heavyweight, he did things that often made him resemble a much larger version of Sugar Ray. Sugar was amazing -- he could knock out an opponent while he was going backwards, he could move from welterweight to middleweight and back to welter. Ray could do a dance around you and suddenly and unexpectedly knock you cold with a left hook. There's never been a fighter like Sugar Ray Robinson, ask Ali if you don't believe me.

* *

I just said hello to Amy Snyder, the last survivor of my mother's friends. Amy will be 105 next October 3. In another week, Amy will have lived through three centuries. Amazing. I asked her what her secret of survival was. She said she honestly didn't know. Actually, Amy used to play a lot of tennis when she was younger. Tennis? Could that be it?

* *

Rodney Dangerfield said that his wife wanted plastic surgery. Said Rodney, "I gave her plastic surgery. I cut up her credit cards."

* *

Last week Joseph Heller died at the age of 76. Heller, like this writer, was a bombardier on B-25s in Europe during WWII (he was in the 448th Squadron, 340th Bomb Group). Heller was the author of the famous book, "Catch 22," although he wrote many other novels. I was in Europe at the same time and stationed near him, but I never met Heller. I wish I had.

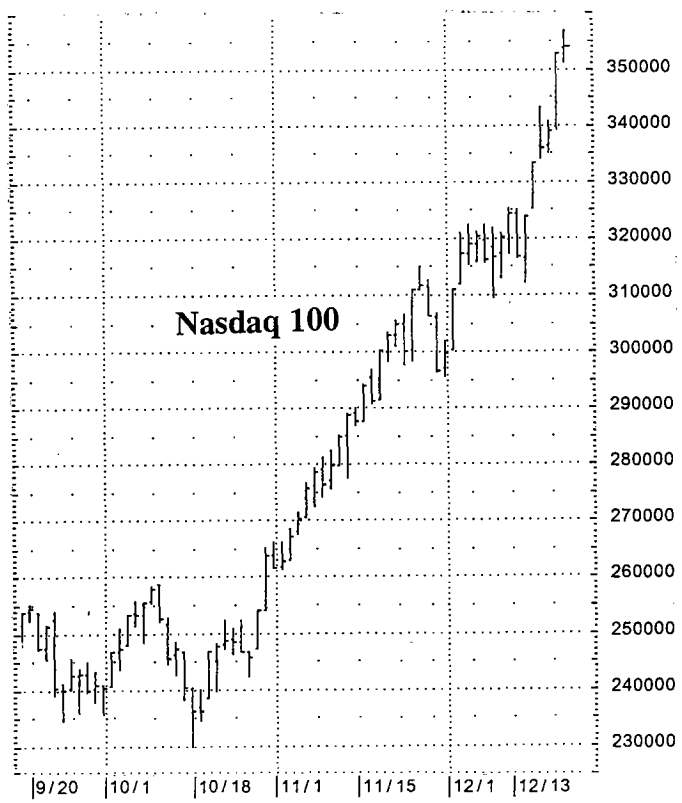
Christmas: The truth: I was never thrilled with the regular store-bought Christmas cards or for that matter, any kind of store-bought cards. I prefer a personal note or a letter telling something about the senders -- actually the letters are my favorites. My second favorites are photos, which usually portray the senders and their kids -- or the sender holding his or her dog or cat or turtle.

In the past I've sent cartoons which I've personally drawn or letters telling what Faye and I have done or what my kids are doing or a picture of Faye and I sitting on Harleys. This year, sad to say, we haven't sent anything out. I can't say exactly why -- I guess the season just "slipped away from us." No matter, most of our friends get these reports, so this is our Christmas Greetings or Season's Greetings to all of my subscribers and to all of our friends.

I want to wish you all the best of health and happiness in 2000 and beyond. If you happen to have stock in a start-up be sure to sell some when the vesting period is up. Take a spoonful of Metamucil with orange juice or water in the morning and one at night (it will reduce your cholesterol and make you a "regular"). Don't forget to floss. Try to take a half-hour nap during the day. And when you're out walking with your spouse, hold hands, it's healthful and looks very sweet. If you're single and lonely, go to some art openings or museums or do your shopping at the supermarket. All three are great places to meet people. Of course, I prefer the beach, where I met two of my three wives. If you even suspect you have heart trouble, investigate chelation on the net. My mother, who lived to be 92, said "Do everything in moderation." Maybe that's the best advice of all.

CHARTS: There are a few charts that I consider KEY charts in the current situation. The first it obvious, it's what I term the "engine" of this wild and woolly explosion in the Nasdaq Composite. Of course, I'm referring to the Nasdaq 100, which consists of the 100 largest-cap non-financial stocks in the Nasdaq Composite. Here we see the almost straight-line rise of October to December. Can this continue into the new year? Should it have occurred in the first place? Who knows, but I know this -- the danger signal would be a close below 3390.

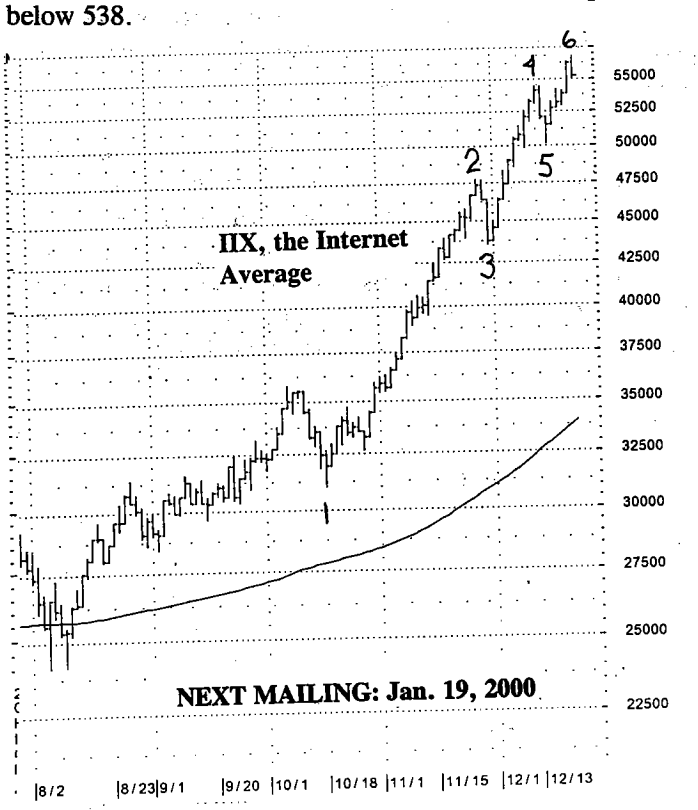
I think what's happened is that hundreds of fund managers decided that they HAD to have representation in the "hot" tech and net stocks, and they bought them at whatever they cost, or should I say regardless of what they cost. This has resulted in the amazing rise in the Nasdaq 100 since October. And of course, these same stocks fired up the Nasdaq Composite and to some extent the S&P 500.



The next chart is the Internet Average or IIX. From a price of 255 last August, the IIX more than doubled to its recent price of over 560. The frenzy to buy Internet stocks has been one of the great speculative crazes in stock market history. I have included the 144-day moving average of the IIX, and you can see how far the IIX is above its long-term

MA. As in the case of the Nasdaq 100, many fund managers feel that by year-end they must show that they had representation in the Internet stock complex. Therefore, you buy them at whatever the market price is -- and if they top out, well, you're in no worse shape than any other fund that loads up on the net stocks. But the operative thought is -- you have to show that you have Internet stocks.

Technicals: Note in IIX that the rise from point 1 to point 2 was large. Next, the rise from point 3 to point 4 was smaller -- and the rise from point 5 to point 6 was still smaller. My initial danger signal would be a drop in IIX below 538.



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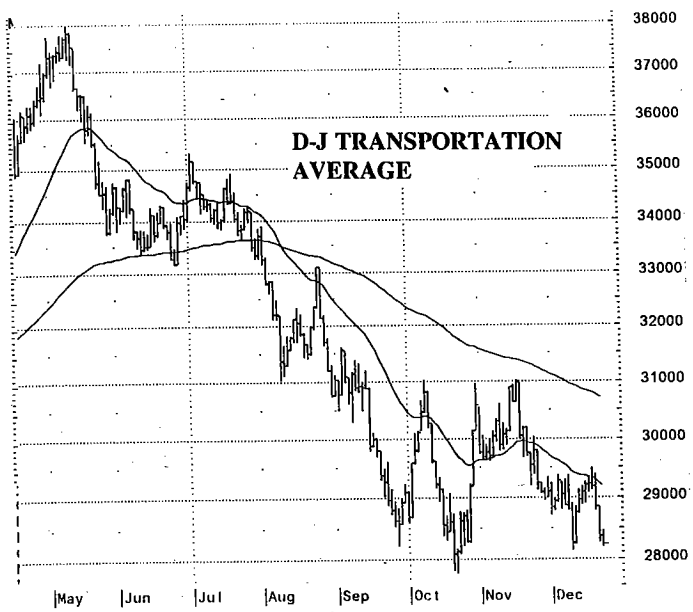


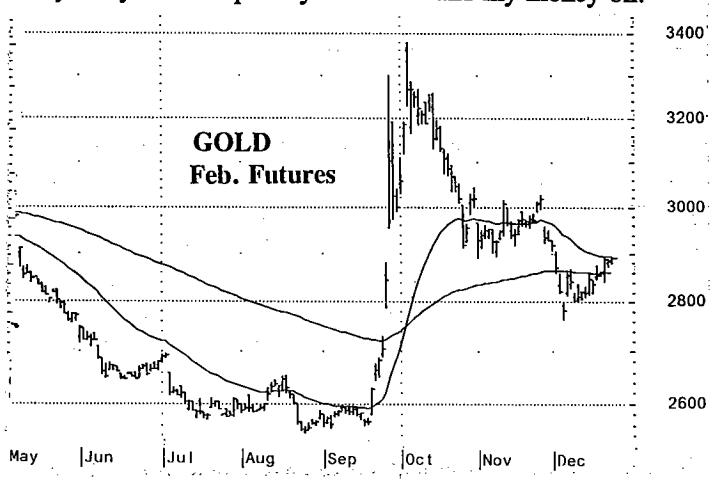
I want to show a more detailed chart of the D-J Transportation Average. The Transports, which are highly leveraged and sensitive to oil prices, shipments, travel, etc., have often led the market both on the upside and the downside. The bear market low for the Transports was 2808.44. The Trannies are not far from that low now. Note that the 144-day moving average is trending down, the 34-day MA is below the 144-day MA, and the Transports are below both. Thus, the Trannies are in the bear mode.

What would it mean if the Transports were to break to a new low? In my opinion, it would be a negative indication for the market in general. So my suggestion is that we keep our eyes on the action of the Transportation -- they are important.

GOLD: I've been besieged for months with various articles, opinions, arguments, explaining why gold should go up, why gold hasn't gone up, why gold is being manipulated, why a tremendous short position is building up in gold and why this short position should, in due time, send gold careening higher.

All, interesting enough and all very convincing -- but I have a confession to make; through long experience, I prefer to go by the price action. I subscribe to the theory that all the information known about any stock is boiled down and distilled into one item -- the price action. You can argue with any theory or set of statistics, but you better not argue with the price action.

So saying, let's take a look at Feb. gold, the active contract. On the plus side, the shorter or 34-day moving average is still holding ABOVE the longer or 144-day moving average. The 34-day MA now stands at 289. If Feb. gold can cross above its 34-day MA at 289, that would put gold back in the bullish mode. If that happens, the next upside objective (and it's an important one) would be for gold to rally above its November high at 303. That's the basic technical story, that's the price action story, that's the only story that I'll put my faith in -- and my money on.



LATE NOTES: I'm rather surprised at today's (early Monday's) action. Dow is up, breadth continuing down, and IIX (the Internet Index) is finally down. Many analysts are talking about a big rally in the mid-cap and small-cap stocks next year. Could be, but if that's going to happen, breadth must turn up. Market sentiment still white-hot bullish. Keep your eye on the Nasdaq and IIX, these two are where the frenzy has been centered. What happens if the frenzy subsides? That's the operative question.